RETIREMENT COMMUNITY DEVELOPMENT: NEW TRENDS IN MARKETING AND FINANCING CONCEPTS

An analysis of marketing techniques is directed at the growing and evolving development of life care communities.

by John A. Rasmussen

The risks of developing or expanding continuing care communities can be reduced by testing alternative financing concepts with primary market research before deciding on a consumer financing plan.

Previously, retirement community residents were required to turn over all their assets to the religious or fraternal-sponsored retirement home in order to receive life-care. Help when needed is still considered important but changing consumer attitudes toward nonrefundable entry fees have resulted in changes. Newer retirement communities now offer alternative plans such as refundable entry fees, market rental plans without entry-fees, and guaranteed fixed appreciation ownership.

A national survey of more than 60 retirement communities and 70,000 retired households indicates that success correlates higher with sponsors who employ consumer research and resident participation in the planning process. There is more to retirement center marketing than slick, glossy brochures; primary market research can predict future sales absorption even before advertising campaigns are planned. While refundable entry fee plans have produced successful retirement communities, some consumer preferences are for alternative concepts, and this form of payment is only one alternative to the traditional life care financing concept.

Early in the planning stages of a retirement community, alternative financing concepts need to be identified. To be considered are those with the strongest consumer market support and the highest likelihood of achieving the desired annual absorption rate for sell-out or rent-up. It is no longer safe to assume the absorption rate will be 30, 40 or 50 units per year. Some projects have been funded, built, and never opened.

John A. Rasmussen *is president and research coordinator for Feasibility Research Group, Ltd., Ann Arbor, Michigan. A specialist in applications of primary market research, he has conducted seminars and programs for professional associations addressing trends in retirement housing and continuing care communities. Rasmussen also has taught at Eastern Michigan University, The University of Michigan and the University of Wisconsin.*

Alternative Marketing And Financing Concepts

There are three basic consumer marketing and financing concepts. While the end financing for each project will be different, it is important to evaluate which concept provides optimum market absorption. The plans are endowment entry-fee, market rental, and ownership (fee simple, condominium, and cooperative).

Entry Fee

Life Care Plans

The life-care entry fee concept originally offered prepaid housing and health care. Now there are as many variations as facilities and some provide guaranteed access to nursing care. The fee may differ with the age of the resident (i.e. the same apartment could be priced higher or lower based upon the resident's age).

Traditional Endowment Plans

The traditional endowment plan entry fee prices the initial charge at 80% of the development cost and the housing units must be resold to amortize the debt. If the financing plan assumes a resale turnover in 10 years and the actual turnover is 14 years due to good care and supportive environment, the project may be a humanitarian success but a financial flop.

Contemporary Endowment Plans

Newer endowment plans price the entry fee at 100% of the estimated development cost attributable to the individual unit without difference for age. This is obviously a safer pricing strategy. The question is whether enough people are willing to pay $80,000-$180,000 for up-front fees.

Refundable Entry Fee Plans

Refundable plans offer a 50-95% refund, but require a higher entry fee. Variations include interest free loans with optional gift provisions and refunds contingent upon resale.

Market Rental

Here there is no entrance fee, only a monthly payment plan that includes debt coverage and services. The monthly fee usually depends on the services offered and is higher than for endowment entry fee plans. The higher monthly payment usually shrinks the market penetration.

Ownership

In this plan an entrance fee (downpayment) represents ownership equity. The downpayment may be 100% of the housing cost or a lesser amount depending on buyer resources and available financing. The amount of the downpayment can be similar to an entry-fee plan, and the monthly payment typically is lower than for an entry fee or market rental plan. Equity is refunded with possible appreciation upon resale.

If sponsors and board members consider consumer marketing and financing other than entry fee plans (refundable or otherwise), risk and sell-out or rent-up absorption time can be reduced. Whichever option is selected should be tested and supported by primary research.

Primary Research

What is primary research? Financial feasibility and market studies may or may not include primary research. Most are based on secondary analysis of population data, rather than measuring demand by identifying a target market and surveying potential residents. Merchandising research is described as primary research of specified subsets of customers and competitive supplies in order to confirm appropriate ratios for the disaggregation of aggregate data to identify location, space and amenity needs, and to specify levels of effective demand.

It is important to use primary research to test alternative marketing and financing concepts as well as location, product, and amenities. Surveying potential residents does not in itself supply key information; research findings must relate to client goals and objectives.

The feasibility of a project depends on the likelihood of the client accomplishing the stated objectives.[1] Thus if the client's budget is predicated on absorbing 264 retirement housing units within 36 months, he could examine the consumer financing plan with the greatest likelihood for an annual absorption of 88 or more units per year.

Primary market research can indicate a potential acceptance of sales and alternative financing. It is risky to judge by gut feeling or substitute direct comparison without site-specific research. Appraisers, real estate consultants, lenders, and clients need to recognize the weakness of the theory that says if it works in Peoria, it should also work here.

The reasoning is if Green Pastures can sell 132 new retirement homes using a refundable entry fee (or condominium plan), then a similar plan will sell here. This is only a variation of the Peoria assumption. The extent of market demand, the *willingness to move* based on preference for location, product, price, and financing, could vary significantly in different communities with similar demographics.

Another form of unsupported reasoning might conclude that if no local sponsor has developed a retirement community using an ownership plan, then a market rental or entry fee plan will work. Do not throw out primary market research because other similar projects do not exist.

Also, if you question the market research findings, review the methodology and the assumptions. When reviewing a merchandising research analysis it is important to look at more than the sample size and the actual number of responses. The quality of the sample may be more important than its size.

Survey	Sample Size	Response Rate	Number of Responses
A	10,000	10%	1,000
B	3,000	33.3%	1,000

The response rate is one indication of the reliability of the survey data. If the response is 30-40% it is safer to assume the merchandising research will provide a more accurate view of market demand than if the survey response rate is 10%.

In describing merchandising research, the objective always is to define a subset with the highest level of interest in the subject matter to maximize survey response rate and intensity of execution of survey formats.[2]

Sample

A Age 65 and over; income over $20,000

B Age 65 and over; Methodist

C Age 65 and over

An age and income qualified sample or a subgroup of retired Methodists will provide a better indication of effective demand than a random survey of the over 65 population. The reliability of a mail versus a telephone survey is another issue. The mailed survey is preferable for retirement housing research and more cost-effective than other methods of data collection.

Comparison Absorption Rates

The cash flow of a new retirement community depends on the size and timing of income from entry fees, rentals, or sales. Absorption time is key. How long will it take to break even? For 250 new independent living units, this could range from two-to five years, depending on the market, the competition, and the four "P's" of marketing strategy: position (location), product, price, and promotion. Research indicates that marketing and financing have a major impact on absorption rates.

Absorption Projection	Rate of Sale Projection	Support Behind Absorption Projection
A	50 units/yr	Census analysis of 2,500 households over age 75 living within 25 miles of the site; assume 2% will move.
B	50	Another project sold 50 apartments in the past year.
C	50	Telephone survey of 5,000 senior citizen households. Fifty percent of households support additional senior housing; assume 2% will move.
C	50	Mail survey of 1,500 retired Methodist households. Five hundred responses; 150 indicate willingness to move to a new retirement community in two-to-five years.

It is risky to base absorption time on census data extrapolation or experience from similar developments. A better method is to rely on telephone surveys rather than on an arbitrary percentage of the elderly from census data. Mailed questionnaires require the most time but can provide quantitative support of a realistic absorption rate. However, many questionnaires test for one financing plan. Thus, primary research indicates the support and risk levels of alternative marketing and financing plans.

Primary Research Test Of Alternative Marketing And Financing Plans

A consumer mail survey of 1,156 retired Methodist households indicates what is expected in terms of alternative payment plans in a new retirement community. A tabulation of 547 responses taken from a sample of 1,156 provides a response rate of 47%. The survey reflects the following demand:

Alternative Financing Plans		
Life Lease Plan	An entrance fee and a monthly payment for a continuing care contract providing housing, services, and the availability of nursing care	5%
Market Rental Plan	A straight rental with no downpayment	23
Ownership Plans	A downpayment or the full price in one sum	45
Other and Not Interested		27
		100%

Survey response indicates the life lease concept has the least appeal of the above three plans when tested. While strong sponsor and partially refundable entrance fees may increase the appeal, it is unlikely that support will approach the demand for the market rental or ownership plans.

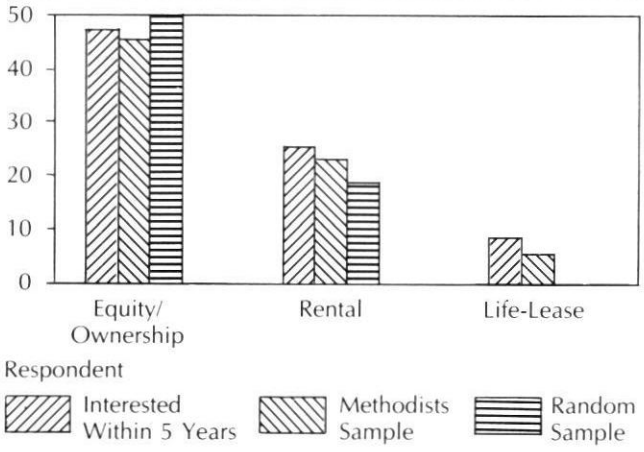
Testing only one financing concept, e.g., the life lease plan, may underestimate demand for market rental or ownership plans. Market rentals with no downpayment are supported by 23% of the respondents whereas an ownership plan is shown to have twice as much market support. Furthermore, primary research allows subgroups of respondents based on preferences for equity ownership, rental, and life lease financing. The three subgroup markets are persons interested in moving within five years; Methodist sample respondents; and random sample respondents.

Endowment Financing Plan Absorption Rates

Between 1971 and 1980, 1,062 endowment plan financed housing units were developed in one market. The five retirement facilities developed averaged 212 units, not counting supportive care and nursing beds. One 225-unit project with an on-site nursing center failed and was converted to a market rental plan. A second center, offering 225 units with endowment plans, changed management twice, was restructured and now is successfully operating under the endowment concept.

EXHIBIT 1

Payment Plan Preference Among Three Groups



Absorption averaged 84 units per year between 1971-80. Between 1981 and 1985, 523 endowment plan units were proposed for five projects; three represented expansion of existing communities, of which two projects were built totaling 105 units. Two new endowment projects were proposed. One with 136 units and onsite nursing, subsequently, was not built. A second 252-unit community was constructed by an organization already operating two nonprofit nursing homes. Four years of combined presale and marketing absorbed only 83 units, and it is now being promoted as a market rental.

While the 1970s revealed an absorption rate of 84 units per year, 1981-85 showed only 33 units per year were being sold. This slowdown indicates increased risk for new larger retirement communities marketing endowment plans.

The low occupancy 252-unit and the unbuilt 136-unit facility relied on census projections to support the number of units developed; no primary research was done.

Retirement communities which offer endowment plans that require residents to prepay 100% of development costs, represent phased expansion of existing retirement centers. One 30-unit expansion was financed successfully with a 50% endowment and a 50% noninterest bearing loan. A similar financing plan for a 75-unit independent living expansion achieved a 75% presale level prior to construction being started. Both sponsors involved potential residents in the planning process and one incorporated mail surveys and focus groups.

The most successful endowment plan projects represent small phased expansion of 75 units or less, rather than new developments of 136-252 units. The most successful developments incorporated surveys and other forms of potential resident participation in the planning process.

Market Rental Financing Plan Absorption Rates

A search was made for market rate rental congregate housing offering meals and support services. Between 1971-80, five projects containing 707 such units were built and absorbed within the surveyed metropolitan

EXHIBIT 2

Endowment Plan Absorption Rates

Year	Endowment Plan Retirement Residences	New Units Developed	New Units Absorbed	Absorption Rate	Comments
1971-80		1,062	837	84/yr	Five Projects
1981	—	—	—	—	
1982	Frankenmuth	252	83[1]	20/yr	Four years of marketing efforts, three marketing firms
1982	Grand Rapids	30	30	30/yr	Expansion of existing continuing care community
1983	Battle Creek	136 proposed (not built)			Project dropped
1984	Grand Rapids	30 proposed (not built)			To be restructured as a market rental
1985	Grand Rapids	75[2]	52	52/yr[3]	Expansion of existing life care community
Total New Endowment Plan Residences 1981-85		357 Built (523 Proposed)	165	(165/5yr) 33/yr	Three projects

[1]New contracts converted to market rentals in 1985
[2]Under construction in 1985
[3]First year absorption rate. Sold out in 1986.

market. The early market rate residences were one-of-a-kind. Three projects were developed in conjunction with existing nursing homes; the other two included a school converted into 88 units and the building of a new structure featuring 375 congregate apartments.

Since the late 70s, one developer, American Retirement Residences, has successfully developed, marketed, and managed 10 congregate residences with other proposed projects in Michigan and Florida. Their experience is probably the best indicator for acceptance of the market rate rental concept.

In addition to the 552 units developed by American Retirement Residences, a second developer converted a private Catholic school into 108 units. Primary market research, which tested entry fee and rental marketing and financing concepts for the building, indicated greater support for market rentals. Model units were built to be preleased in 1984, and the project opened in September 1985 with 50% occupancy. In six months, occupancy reached 75%. The monthly rentals of $800-$1,500 were substantially higher than other apartments in the area. While the absorption rate was slower than the rent-up rate of apartments without central dining, fill-up was faster than absorption for congregate units with entry fees.

American Retirement Residence rentals range from $900-$1,100 per month, with three meals daily. The units consist of efficiency or one-bedroom with private baths; each location offers central dining, a social director, housekeeping staff, and minivan service. The depth of management experience and the economies of scale of a multisite operation contribute to the success of residences.

The eight congregate market rate rental retirement projects built between 1981-85 in Michigan averaged 70 units, an overall size that helped achieve full rent-up absorption in less than a year. A development of 375-units built before 1981 rented slowly, perhaps because of its architectural design where some apartments were located a distance from the dining room. In Florida and California, congregate apartment-communities with 200-570 units have achieved satisfactory absorption with improved architectural design, good locations, and experienced management.

Congregate rentals require longer rent-up time than most developers expect; sometimes they may require the same absorption time as entry fee plans. The decision to offer market rate rentals rather than entry-fee or ownership plans should be evaluated carefully against the results of primary research and analysis of the competition. Increasing the advertising budget is a poor trade off for a project that lacks adequate market support.

Ownership Financing Plan Absorption Rates

Ownership financing plans include fee simple ownership for single family residential use, condominium units in condominium plats, and cooperative units on cooperative owned or leased land.

Fee Ownership: Single Family Detached

While the Del Webb Development in Sun City, Arizona, is a successfull example of single family, fee simple ownership, few new large scale retirement cities exist in northern states.

EXHIBIT 3

Market Rental Financing Plan Absorption Rates
Market Rental Congregate Housing

Year	Market Rental Locations	Building Conversion	New Construction	Total Units Developed	Total Units Absorbed
1971-80	Metro area	1	4	707	682[1]
1981	Royal Oak	62	—	562	62[2]
1982	Royal Oak II	38 (80 Bed NH conv.)	—	38	38[2]
1983	Lincoln Park	99 (160 unit motel conversion)	—	99	99[2]
1984	Livonia	—	84	84	84[2]
1984	Stone	58	(29P)	58	58[2]
1985	Elmwood	44	(25P)	44	44[2]
1985	Farmington Hills	61	30	91[2]	
1985	Dearborn Heights	46	30	76[2]	
1985	Monroe	108		108	81[3]
(P = Proposed)		516	144	660	466

[1]Includes 375-unit project which experienced slow rent-up (see text).
[2]Data Source: American Retirement Residences
[3]Project opened in September 1985 and is still in rent-up stage. A 50% occupancy level achieved at opening resulted from 18 months of preleasing efforts.

Condominium: Cluster Housing And Apartments

Leisure Tech's planned unit development at Leisure Village in Southern California is a successful adult and retirement community of cluster housing in the $139,000 to $190,000 price range. It features platted lots and association ownership of the community building, dining facilities, and recreational amenities. Planned for a build-out of 1,700 units, similar concept developments are being constructed in Lakewood, New Jersey and Long Island, New York. The concept targets preretirement (age 50 and over) and retired households. In Florida, condominiums are marketed to empty nesters, single professionals, retired households, and second home owners generally from northeastern and midwestern states.

Cooperative: Cluster Housing And Apartments

An ownership concept now being targeted to retirees and empty nesters is the market rate cooperative. Not to be confused with government subsidized cooperatives developed in the 60s and 70s, the market rate cooperative began in 1978. Its prototype is the successful 338 apartment highrise, 7500 York, developed by the Ebenezer Society in Edina, Minnesota. This building features central dining and secure underground parking, where the residents serve on the board of directors and on 17 committees.

In a cooperative, residents purchase shares and pay a portion of the mortgage. Unlike older cooperatives, the residents are not now personally liable for the underlying mortgage. Resale of cooperative apartments was a problem in the past. Now that shareholder loans are available, sellers may offer up to 90% financing on their equity, resulting in a 95% loan-to-value ratio of the total price. The cooperative shareholder only needs to refinance his equity value, not the underlying mortgage as required when selling a condominium.

Of the four market rate cooperatives in Michigan, the largest developer is Centaur Builders. With three developments totaling 1,848 units proposed and 600 units sold, the cooperative is reaching higher absorption rates than condominium or market-rental concepts.

With 1,048 proposed cluster homes, Centaur's Colonial Acres marketed to retired households in 1974. Since then, the market has shifted to 50-to-65-year-olds. Of the 470 cooperative cluster homes sold through 1985,

EXHIBIT 4

Market Rate Cooperative Housing

Year	Market Rate Cooperatives	New Construction	Total Units Sold
	Colonial Acres	All New	
1974-80			295
1981			52
1982			20[1]
1983			20
1984			48
1985			35
			470
	Centennial Farms	All New	
1980			12
1981			18
1982			10[1]
1983			10
1984			30
1985			40
			120
	Red Cedar	All New	
1984			—
1985			6
	Geddes Lake	Conversion	
1982			100[2]
1983			80
1984			75
1985			46
			301

[1]The absorption rates for new construction are as expected, at a slower rate than for conversion sales.

[2]The slow housing market of 1982-83 impacted upon new construction, but because finished product and favorable financing were available, the cooperative sales absorption was not hurt.

EXHIBIT 5

Comparison Absorption Rates For Alternative Financing Plans 1981-85

Financing Plan	Total Projects Developed	Total Units Developed	Total Units Absorbed	Absorption Rate per Year
ENDOWMENT	3	357	163	33[1]
MARKET RENTAL	8	493	466	93[1]
		167 to open in 1986		
OWNERSHIP				
New construction	3	596	301	60[1]
Conversion	1	360	291	73[2]

[1]Total combined absorption of all projects
[2]Excludes sales to investors prior to resale to individuals

the developer estimates 80% are occupied by retirees with a mix of 75% couples and 25% single person households. Colonial Acres had a slow sales start because of a limit on sewer and water taps (48 per year), and the depressed housing market conditions of 1982-83.

Centennial Farms, a cooperative cluster housing community also developed by Centaur Builders, is a self-contained community of 440 units built in several phases. Since development began in 1979, 120 units have sold.

Red Cedar Cooperative began with four models in 1984 and included 20 additional units of which six were sold. In 1986 the developer expects to market 20 units at Red Cedar and 80 units between Centennial Farms and Colonial Acres.

Geddes Lake Cooperative, with 360 townhouse clusters, is the first successful market rate cooperative conversion in Michigan. Sales began in 1982, and in spite of the then depressed housing market, 100 units were sold. Absorption totaled 80 units in 1983, 75 units in 1984, and 46 units in 1985. The remainder were acquired by investors for short term holding and resale. This cooperative was marketed to all market segments—empty nesters, retirees, families, and single person households.

Summary Of Absorption Analysis

Data indicate that the *total absorption* of 163 units is less for the endowment financial plans than for market rate rentals or cooperative ownership plans. The *average annual absorption* for endowment financing plan retirement communities is approximately 50% lower than either market rental or cooperative ownership plans. This data base includes all known endowment projects and market rate cooperatives marketed. Additional market rate rental communities, developed or in the planning stages, would increase the overall number of units.

Considering the 1,062 endowment plan retirement community units built in Michigan between 1971 and 1980, the data for 1981-85 indicate that endowment financing is declining. Refund plans may slow the rate of decline, but are unlikely to reverse the trend.

Market rental congregate housing appears to be growing in popularity, with an average annual absorption at triple the rate of other projects with endowment-financing plans.

The cooperative housing financing concept has easily surpassed the endowment plan absorption rate. The potential of the ownership concept (cooperative) appears to be even greater than for market rental. The future of the ownership concept could approach an

EXHIBIT 6

Projected Absorption Rates By Financing Concept
(Impact of Financing Plan on Absorption Rates)

Financing Plan	Share of Market[1]	Potential Absorption	Acutal Absorption 1981-1985
Endowment Plan	5%	33 units/year	33 units/year
Market Rental	23%	152 units/year	93 units/year
Ownership Plan	45%	297 units/year	60 units/year new construction 73 units/year conversion

[1]Market share ratios from survey responses of 547 retired Methodist households.

absorption rate of 297 units per year in Michigan. In Minnesota, with 772 retirement cooperative units built or under construction, 690 have sold. Additional cooperative retirement communities are planned or are under construction in Florida, Pennsylvania, and Wisconsin.

To project the potential market for the ownership concept, one assumes absorption of 660 retirement housing units per market. Not known is how much the type of financing offered will impact or if the same building design and services are offered, what extent the financing plan increases or decreases the absorption.

Financing Concepts Of The Future

The future for retirement community financing appears to be headed in the direction of market rate rental and cooperative ownership alternatives. Given the same location and facility design, the financing plan appeal to the potential customer must be examined from a consumer point of view. Which is more appealing—a life lease with a 50-95% refundable plan, a market rate rental, or a market rate cooperative? Primary market research indicates placing your bet on market rate rental and market rate cooperatives.

The future is here. The increasingly sophisticated consumer will vote for his/her favorite financing with dollars. Primary market research provides the decision-maker a more accurate view of the market.

NOTES

1. Williams, Thomas P., MAI and Rasmussen, John A., (1985, July). Feasibility and Valuation of a Continuing Care Retirement Community. *The Appraisal Journal*, p. 364.
2. Graaskamp, James A., CRE, (1985, Spring/Summer). Identification and Delineation of Real Estate Market Research. *Real Estate Issues*, pp. 9-10.